



British Embassy Tokyo

Key Points

- A 1tn yen (£5.7bn) stimulus measure in FY2015 budget is under consideration to mitigate the impact of another VAT increase
- Investment in FY14 is expected to increase by the fastest in 24 years and wages rise by the highest in more than 17 years
- Consumption data in July remains weak despite expectations of earlier recovery
- JGB yields hit their lowest (below 0.5%) since April 2013

[This report reflects data available up to 2 September 2014.]

Please contact [Sunil Sood](#) and [Akira Maekawa](#) with any comments or questions

AUG 2014: JAPAN ECONOMIC MONTHLY REPORT

5 September 2014

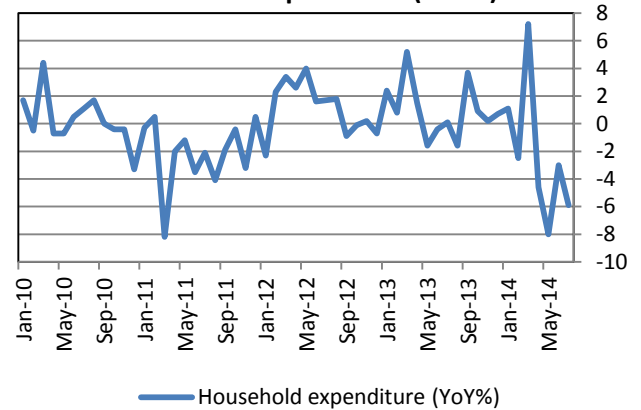
1. The Government is considering a 1tn yen (£5.7bn) stimulus measure in FY2015 budget to mitigate the impact of increasing VAT from 8% to 10% in October 2015. The decision is likely to be based on Q3 GDP data.
2. Other measures, under consideration, to stimulate growth include :
 - Cash subsidies for low earners for house purchases
 - Abolishing automobile acquisition taxes
 - Extending an inheritance tax waiver for house purchases
 - Introducing different VAT rates for items such as food.

The Government has said that it will not rule out larger stimulus packages if economic conditions require them. According to a recent Nikkei survey on 2014/15 growth forecasts, most private economists now expect a stimulus package of between 2-5tn (£12-29bn) yen size.
3. Japanese ministries have submitted funding requests totalling 101.7tn yen (£586bn) for the FY2015 budget of which 3.9tn yen (£23bn) has been requested in support of the growth strategy. This compares to an overall government budget of 95.9tn (£553bn) yen in FY2014. If all funding requests are granted in full (unlikely), this will be the first budget exceeding the symbolic 100tn yen (£576bn) figure. The Government will finalise its draft budget in December. It is also expected to include cuts in the rate of corporation tax. Once debt servicing costs, social security expenses, and grants to local governments have been deducted, the remaining discretionary budget is about 25% of total spending.
4. The Bank of Japan's (BOJ) announced no change to monetary policy in August. It continues with its Quantitative and Qualitative Easing (QQE) with the intention of reaching its 2% inflation target. The BOJ continued to see Japan's economy 'recover moderately' despite their slight downgrade in its assessment on exports. Looking ahead, it sees inflation expectations rising though it expects inflation to remain near 1.25% for the next few months.

Economy

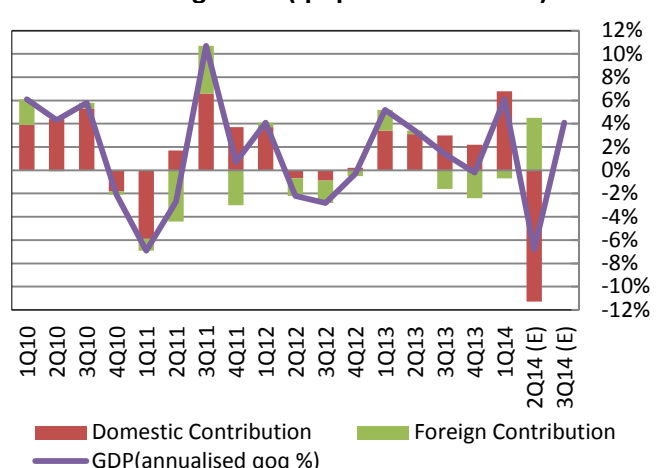
5. Many economic commentators believe that the economic situation has improved sufficiently to support the proposed October 2015 VAT increase. This proposal only has 30% of public support.
6. There continues to be some positive signs in Japan's economy. According to a Development Bank of Japan survey, investment in FY2014 is expected to have increased at its fastest pace (15.1%) in 24 years. Nominal wages including bonuses rose by 2.6%, the fastest rate in more than 17 years. Summer bonuses have increased 7.19%, which is the highest in 24 years. Leisure expenditure also increased for the first time in 11 years in 2013, while the number of corporate bankruptcies fell below 1,000 for the first time in 23 years.
7. Recent economic data highlights some of the downside risks to Japan's economic recovery:
 - July household expenditure fell. This is the fourth month it has fallen despite expectations that private consumption would increase a few months after the rise in VAT.
 - July industrial production rose slightly but less than expected. Production in durable consumer goods such as cars and consumer electronics was also mainly affected by weak domestic demand.
 - The unemployment rate in July slightly rose to 3.8% from June's 3.7%. This was the second consecutive monthly rise. The number of unemployed rose mainly because housewives newly registered as being available to work but remains near the rate of full employment.

Chart A: Household expenditure (YoY%)



8. Q2 GDP growth contracted sharply (-6.8% annualised rate) as expected. This was mainly as a result of poor private consumption following the April VAT increase. It is the worst fall since March 2011, leading some commentators to suggest that Abenomics is failing. Domestic demand also fell by 10.5% (annualised) led by a sharp fall in private consumption, private capital investment and housing. The Cabinet Office estimates the output gap as -2.2% of GDP in the Q2. The BOJ has not yet released its own estimate but this tends to forecast a smaller output gap.

Chart B: GDP growth (qoq annualised rate)



9. July CPI showed core CPI inflation (excluding fresh food) rose by 3.3% YOY, (2% of which is estimated to be due to April's VAT rise). This is the fourteenth consecutive monthly increase.
10. For the 25th consecutive month, Japan's imports have exceeded its exports (deficit: 964 billion yen [£5.6bn] in July), driven largely by energy imports following the shutdown of nuclear reactors. However, as exports have increased the overall trade deficit has fallen, although their recovery remains sluggish.

Trade Policy

11. Japan and the US resumed bilateral discussions on the TPP, covering automotive and agricultural issues. TPP Chief Negotiators will meet in Hanoi in September. Major issues such as intellectual property rights, reform of state-owned firms and rules of origin remain to be resolved.

Private Sector

12. The Bank of Tokyo-Mitsubishi UFJ, Mizuho Bank and Japan Bank for International Corporation (JBIC) are to lend 63bn yen (£363ml) to a UK ocean wind-power generation project. JBIC and others are also to lend US shale gas projects in which Japanese firms hold an interest with about 1tn yen (£5.7bn) loans. According to a Nikkei survey, 20% of firms plan to launch or expand their R&D projects overseas.

Markets

13. Japanese Government Bond yields hit their lowest point (below 0.5%) since April 2013 when the BOJ started the QQE. Underlying robust demand from the BOJ has been pushing down market interest rates.
14. Financial markets focused on reform of the Government Pension Investment Fund (GPIF), one of the largest pension funds in the world. Speculation that Yasuhisa Shiozaki, a well-known GPIF reform advocate, would be appointed as the welfare minister, has been supporting equity markets. (This proved to be the case in the Japanese Cabinet reshuffle on 3 September – see reporting diptel. We will report any further economic implications of the reshuffle in next month's report.)

Comment

15. Policy makers and economic commentators were surprised by July's economic data showing the fourth consecutive monthly drop in overall consumption since the April VAT increase. Policy makers still believe that the underlying trend of economic recovery remains intact. Coupled with the comparatively low increase in exports, this has given rise to concerns being voiced about the prudence of increasing VAT to 10% if domestic demand is to help drive Japan's recovery.

Chart 1: CPI (%Y/Y)

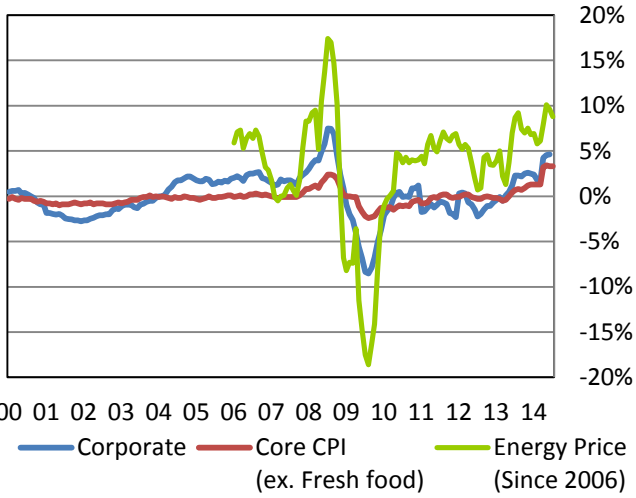


Chart 2: Labor Market

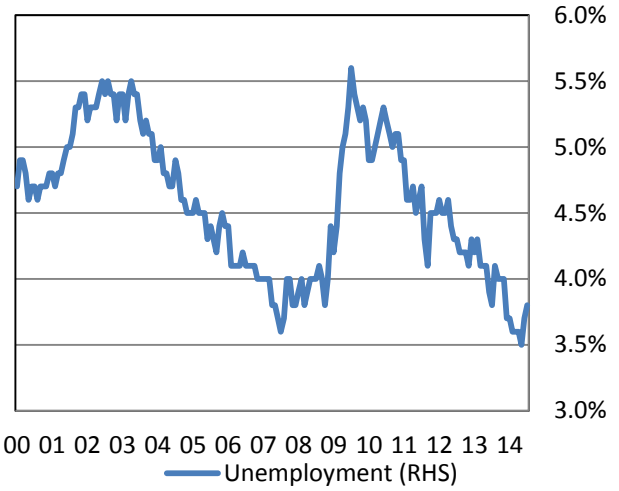


Chart 3: Real wage (%Y/Y)

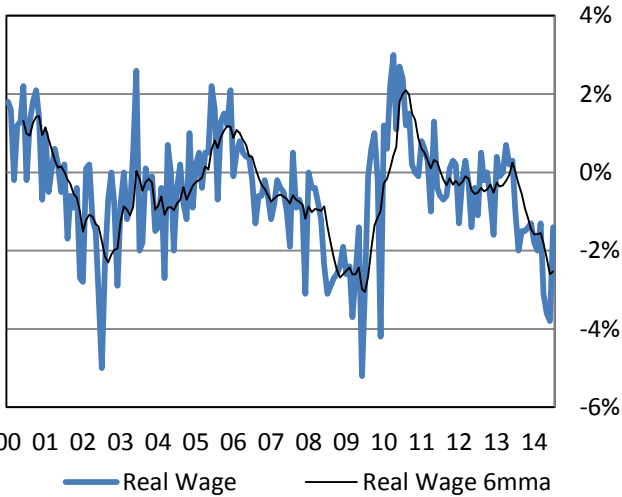


Chart 4: Real GDP (% Q/Q)

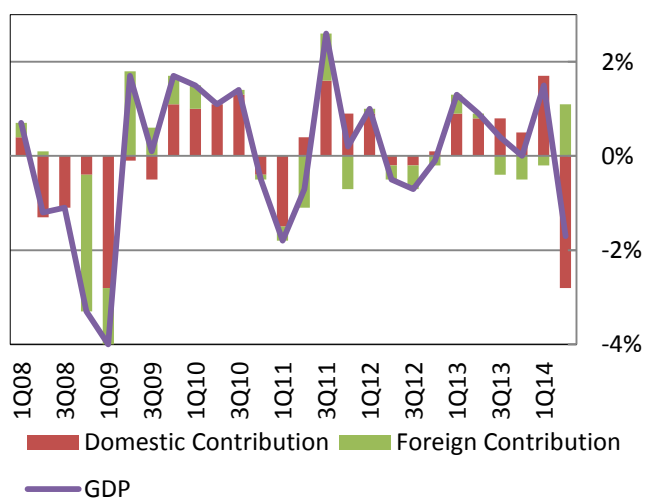


Chart 5: Stock Market

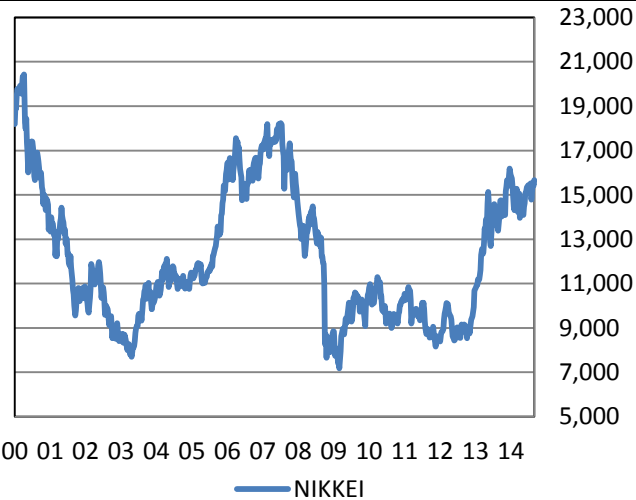


Chart 6: Yen

